Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009

Message Text

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PAGE 01 BELGRA 03284 01 OF 02 231123Z
ACTION EUR-12

INFO OCT-01 ISO-00 SP-02 USIA-06 AID-05 EB-07 NSC-05
EPG-02 TRSE-00 SS-15 STR-04 OMB-01 CEA-01 CIAE-00
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R 230830Z MAY 77
FM AMEMBASSY BELGRADE
TO SECSTATE WASHDC 729
INFO AMEMBASSY LONDON
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E.O. 11652: N/A
TAGS: EFIN, YO
SUBJECT: YUGOSLAVS BALK AT CERTAIN EUROCURRENCY LOAN CLAUSES

SUMMARY. EUROCURRENCY LOANS TO YUGOSLAVIA CONTAINING CERTAIN CLUSES DESCRIBED BY AMERICAN BANKERS AS STANDARD ARE NOW IN LIMBO, AS FIRST POLITICAL AND LATER COMMERCIAL OBJECTIONS HAVE LED TO AN ONGOING REVIEW OF THE CLAUSES BY THE NATIONAL BANK. UNTIL THIS REVIEW IS COMPLETED AND INSTRUCTIONS ISSUED TO THE COMMERCIAL BANKS, ALL LOANS CONTAINING THE SUDDENLY-CONTROVERSIAL CLAUSES ARE BEING HELD UP OR RENEGOTIATED. ALTHOUGH THE OUTLOOK IS UNCERTAIN, IT APPEARS THAT THE YUGOSLAVS WILL BQFIRM IN RE-JECTING ANY CLAUSE WHICH ALLOWS A FOREIGN LENDER TO UNILATERALLY RECALL A LOAN ON THE BASIS OF CURCUMSTANCES WHICH ARE BEYOND THE CONTROL OF THE YUGOSLAV BORROWER. END SUMMARY.

1. IN EARLY 1977, YUGOSLAV GOVERNMENT AND BANKING AUTHORITIES BEGAN TO SHARPLY QUESTION THE VALIDITY AND JUSTIFICATION FOR SEVERAL CLAUSES IN EUROCURRENCY LOANS WHICH AMERICAN BANKERS
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PAGE 02 BELGRA 03284 01 OF 02 231123Z

CLAIM ARE "STANDARD" IN THESE LOANS. YUGOSLAV ATTENTION WAS REPORTEDLY DRAWN TO THE CLAUSES BY AN AMERICAN BANKER'S COMMENT THAT THE CASE OF YUGOSLAVIA, THE CLAUSES WERE POLITICAL IN NATURE. WHILE THE INITIAL YUGOSLAV REACTION FOCUSED ON ONE OR TWO SPECIFIC CLAUSES AND WAS STRINGLY BASED ON THE ALLEGED POLITICAL FNTURE OF THE CLAUSES, SUBSEQUENT REVIEW OF OTHER CLAUSES IN THE LOAN AGREEMENTS HAS LED TO

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009

OBJECTIONS TO A TOTAL OF FIVE CLAUSES ON POLITICAL AND/OR COMMERCIAL GROUNDS. AMERICAN BANKS ARE BLAMED FOR ORIGINATING THE CLAUSES WHICH "SPREAD LIKE A DISEASE", ACCORDING TO A SENIOR NATIONAL BANK OFFICIAL. (WE UNDERSTAND THAT U.K. AND FRENCH BANKS HAVE BEEN INCLUDING THE CLAUSES AS WELL.)

2. THE TWO CLAUSES WHICH CONCERNED THE YUGOSLAVS ORIGINALLY AND WHICH THEY ORIGINALLY JUDGED TO HAVE POLITICAL, AS WELL AS COMMERCIAL ORIGINS ARE:

A. AN ILLEGALITY CLAUSE. IF ANY FOREIGN REGULATORY AGENCY OR GOVERNMENT BODY DECLARES THE LOAN ILLEGAL AT ANY TIME, THE FULL LOAN IS IMMEDIATELY REPAYABLE.

B. EUROCURRENCY MARKET COLLAPSE. IF FOR ANY REASON THE EUROCURRENCY MARKET COLLAPES, THE FULL LOAN IS IMMEDIATELY REPAYABLE.

THE NATIONAL BANK OFFICIAL EXPLAINED THAT THE ILLEGALITY CLAUSE IS LIKE A SWORD OVER YUGOSLAVIA'S NECK, READY TO FALL IN A TIME OF CRISIS. WHETHER IT WAS ACTUALLY APPLIED OR NOT WOULD BE IRRELEVANT, AS IT WOULD BE A THREAT THAT YUGOSLAVIA WOULD HAVE TO CONSIDER IN ANY CASE. HE WENT ON TO POINT OUT THAT YUGUSLAVIA WOULD BE USING THE LOANS FOR LONG-TERM PROJECTS AND TO REQUIRE FULL REPAYMENT AT ANY TIME, EVEN IF THE YUGOSLAV BORROWER WAS CURRENT IN HIS PAYMENTS, WOULD BE AN UNACCEPTABLE HARDSHIP TO THE YUGOSLAVS. HE EMPHASIZED REPEATEDLY THE UN-FAIRNESS OF A CLAUSE WHICH WOULD PENALIZE A LENDER FOR EVENTS COMPLETELY BEYOND HIS CONTROL. SIMILAR STATEMENTS HAVE BEEN MADE TO EMBASSY OFFICERS FROM A VARIETY OF GOVERNMENT AND BANKING OFFICIALS. THEY FEEL THAT YUGOSLAVIA AND SOME OTHER COUNTRIES (BRAZIL AND CHILE ARE OFTEN MENTIONED) ARE REQUIRED

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TO AGREE TO THESE CLAUSES, BUT OTHER COUNTRIES ARE NOT. AMERICAN BANKERS, IN CONTRAST, CALL THEM "STANDARD" FOR ALL EUROCURRENCY LOANS.

3. THREE OTHER CLAUSES WHICH BOTHER THE YUGOSLAVS INCLUDE:

A. TAXATION CLAUSE. IF COSTS TO THE LENDER FOR THE LOAN ARE INCREASED DUE TO TAXATION ON THE LOAN, THESE COSTS WILL BE PASSED ON TO THE BORROWER.

B. SUBROGATION. IF THE BORROWING ENTERPRISE DEFAULTS AND THE YUGOSLAV BANK GUARANTOR MAKES A REQUIRED PAYMENT, THE YUGOSLAV GUARANTOR IS ENJOINED FROM TAKING LEGAL ACTION AGAINS THE DEFAULTER UNTIL THE FOREIGN BANK HAS COMPLETE REPAYMENT OF THE LOAN.

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PAGE 01 BELGRA 03284 02 OF 02 231111Z
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LIMITED OFFICIAL USE SECTION 2 OF 2 BELGRADE 3284

C. ARBITRATION. THE FOREIGN LENDER CAN CHOOSE THE SITE
OF ABRITRATION.

4. IN LATE MARCH, THE NATIONAL BANK ISSUED A DECISION WHICH
PROHIBITED COMMERCIAL BANKS IN YUGOSLAVIA FROM ACCEPTING LOANS
WHICH CONTAINED CLAUSES SUCH AS DESCRIBED IN PARAGRAPH 2.
THIS DECISION ALPROMISED THAT INSTRUCTION WOULD BE ISSUED
FOR "IMPLEMENTATON" OF THE DECISION. THIS WAS INTERPRETED BY
THE ASSOCIATION OF BANKS TO MEAN THAT ALL FIVE CLAUSES WERE
DISALLOWED UNTIL THE INSTRUCTIONS WERE ISSUED. UNTIL NOW,
THESE INSTRUCTIONS HAVE NOT BEEN FORTHCOMING AND SEVERAL LOANS
ARE REPORTEDLY IN LIMBO AS A RESULT. A NATIONAL BANK OFFICER
TOLD EMBOFF ON MAY 2 THAT THE MATTER WAS "MORE DELICATE" THAN
ANYONE HAD PREVIOUSLY THOUGHT AND CONSEQUENTLY IT WOULD BE AT
LEAST TWO MORE WEEKS UNTIL DECISIONS WERE REACHED AND INSTRUC-
TIONS ISSUED. WHILE HE WAS UNWILLING TO SPECULATE ON THE FATE
OF EACH CLAUSE, HE BELIEVED THAT THE CLAUSES WHICH CALLED FOR
FULL REPAYMENT OF THE LOAN FOR REASONS BEYOND THE BORROWER'S
CONTROL WOULD DEFINITELY BE OUTLAWED. THE OTHER CLAUSES, ACCORDING
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PAGE 02 BELGRA 03284 02 OF 02 231111Z

TO THE OFFICIAL, MAY BE LEFT FOR THE COMMERCIAL BANKS TO DECIDE.
HE ALSO EXPLAINED THAT THE LOANS INVOLVED WERE ONLY PURE
FINANCIAL CREDITS AND THUS ONLY A PORTION OF YUGOSLAVIA'S TOTAL
BORROWING--IN FACT, ONE OF THE LESS-FAVORED PORTIONS. EQUIPMENT
CREDITS AND LOANS FROM STATE AND INTERNATIONAL AGENCIES ARE MORE

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009

FAVORABLY RECEIVED AND ARE NOT TOUCHED BY THE CONTROVERY.

5. SOME BANKS, INCLUDING AMERICAN ONES, HAVE REPORTEDLY STRICKEN THE OFFENDING CLAUSES FORM BANK-TO-BANK LOANS IN ORDER TO GET THEM APPROVED. AMERICAN BANKERS VISITING THE EMBASSY ACKNOWLEDGE THESE DEALS, BUT STATE THAT IN DEALS INVOVLING LARGER SUMS OR MORE THAN ONE BANK, IT WOULD BE MUCH MORE DIFFICULT TO ELIMINATE THE CLAUSES. INTERNATIONAL BANKS, THEY SAY, WOULD BE RELUCTANT TO SET THE PRECEDENT OF WAIVING THESE CLAUSES FOR ONE COUNTRY WHEN THEY ARE APPLIED TO SO MANY MORE.

6. COMMENT: WHILE THERE ARE COMMERCIAL REASONS FOR YUGOSLAV DISAGREEMENT WITH THESE CLAUSES, THE PROBLEM CAME TO THE FORE FOR POLITICAL REASONS AND ANY RESOLTUON WILL BE PRIMARILY A POLITICAL ONE. INTERNATIONAL BANKERS WILL BE DEALING WITH THE YUGOSLAV BANKING COMMUNITY IN RESOLVING THIS ISSUE, BUT THESE BANKERS IN TURN ARE UNDER PRESSURE FROM POLITICAL FORCES WHICH WILL BE UNIMPRESSED WITH COMMERCIAL REASONS FOR THE EXISTENCE OF THE CLAUSES, PARTICULARLY THOSE INVOLVING RECALL OF THE LOAN. THE BANKING COMMUNITY HAS BEEN UNDER HEAVY CRITICISM LATELY FOR HIGH 1976 EARNINGS AND INTEREST CHARGES AND CONSEQUENTLY IS PROBABLY LESS WILLING --OR ABLE --TO STAND UP TO THIS TYPE OF PRESSURE.

7. A STANDFAST POSITION BY THE INTERNATIONAL BANKING COMMUNITY WOULD MOST LIKELY BE MET BY AN EQUALLY HARD POSITION ON THE PART OF THE YUGOSLAVS. OTHER THAN ELIMINATION OF THE CLAUSES, A REWORDING WHICH MORE SPECIFICALLY DESCRIBES CONDITIONS UNDER WHICH THE REPAYMENT WOULD BE APPLIED AND WHICH WOULD REMOVE THE ARBITRARY NATURE CURRENTLY EXISTING MAY BE A SOLUTION, PARTUCULARLY ON THE ILLEGALITY AND EUROMARKET COLLAPSE
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CLAUSES. THE YUGOSLAVS MIGHT BE WILLING TO BEND ON THE TAXATION CLAUSE, ALTHOUGH WE WOULD NOT KNOW HOW MUCH FLEXIBILITY FOREIGN BANKS HAVE ON THIS ISSUE. COMPROMISES ON THE SUBROGATION AND ABRITRATION ISSUES SHOULD BE RELATIVELY EASY TO WORK OUT.

8. NOTWITHSTANDING THE LIKELIHOOD OF ANY COMPROMISES, PROBABLY IT WILL TAKE SOME TIME FOR YUGOSLAV FINANCIAL CIRCLES, OFFICIAL AND COMMERCIAL, TO REACH A CLEAR POSITION ON EACH CLAUSE. THEY HAVE JUST BEGUN TO CONSIDER THE COMMERCIAL IMPLICATIONS OF A DECISION HASTILY TAKEN ON POLITICAL GROUNDS. (WE HAVE SEEN SIMILAR INSTANCES, AS WHEN THE YUGOSLAVS PROVED SURPRISED AT THE SHARP FOREIGN REACTION TO THE ILL-CONCEIVED AND SLOPPILY DRAFTED JUNE 1976 REGULATION ON FOREIGN INVESTMENT, MANY OF WHOSE PROVISIONS REPORTEDLY HAVE BEEN DROPPED FROM A NEW DRAFT LAW.)

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009

9. THE EMBASSY OFFERED TO THE FINANCE SECRETARIAT TO USE OUR INFORMATION SERVICES TO INFORM THE U.S. BANKING COMMUNITY OF YUGOSLAV PREOCCUPATION OVER THE CLAUSES. AFTER INITIALLY AGREEING TO PROVIDE INFORMATION AND EXPLANATION OF THEIR CONCERN, THE FINANCE SECRETARIAT RENEGED, DIRECTING US TO THE BANKING ASSOCIATION ON THE GROUNDS THAT UNDER THE SELF-MANAGEMENT SYSTEM COMMERCIAL BANKS WERE MAKING THE DECISION. THE NATIONAL BANK ASSUMED ESSENTIALLY THE SAME POSITION, TELLING US THAT ITS INSTRUCTIONS ON THIS ISSUE MERELY REFLECT THE WISHES OF THE COMMERCIAL BANKING COMMUNITY. THE BANKING ASSOCIATION, HOWEVER, TELLS US THAT IT AND ITS MEMBERS AWAIT DECISIONS OF THE NATIONAL BANK.

10. UNDER THESE CIRCUMSTANCES, FOREIGN BANKS ARE LEFT IN A STATE OF CONFUSION. INDIVIDUAL YUGOSLAV BANKS, ACTING UNIFORMLY --UNDER FEDERAL GUIDANCE, WE WOULD SUSPECT -- ARE ISOLATING INDIVIDUAL FOREIGN BANKS AND ATTEMPTING TO DETERMINE WHAT CONCESSIONS THEY CAN NEGOTIATE ON THE CLAUSES. WE HAVE RECENT INDICATIONS THAT ON A BANK-TO-BANK BASIS, U.S. BANKS ARE
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WILLING TO ELIMINATE OR RENEGOTIATE THE CLAUSES. YUGOSLAV BANKS HAVE NOT BEEN SUCCESSFUL AS YET ON SYNDICATED LOANS. END COMMENT.
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EO Systematic Review
22 May 2009
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